

INFORMATION, PARTY AUTONOMY AND ECONOMIC AGENTS IN EUROPEAN CONTRACT LAW

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1. Introduction

Party autonomy – in the sense of freedom of contract, or self-arrangement of legal relations by individuals according to their respective will – and the limits of party autonomy comprise one of the fundamental questions of national contract and private law, perhaps even the most fundamental. Today the limits of party autonomy are fixed mainly at the European level, especially if market structure is the issue and not so much individual weakness. The question has to be discussed at the European level anew (see below 2). Diverging views of 15 Member States must be considered. It is not just the level at which the question is regulated which has changed, but also the approach. This theme will be developed in the remaining sections. In Europe, mandatory rules prescribing disclosure prevail, but the substantive choice of contract contents is left to the parties' autonomy (see below 3). In construction, these rules are similar to the traditional mandatory rules regulating the content of the contract. In their scope, however, they differ fundamentally from traditional mandatory rules: they are designed to enable party autonomy, they do not restrict the variety of products and contractual conditions available. It will be argued that these rules thus remedy market failure in the case of unavoidable information asymmetries, but at the same time do not unnecessarily restrict market mechanisms (see below 4). It is therefore an important development that the European Court of Justice holds, on the basis of the fundamental freedoms, that information rules must be preferred to mandatory rules prescribing substance, whenever meaningful information of the client is possible (see below 5). It will be argued that indeed the bulk of contract-related secondary EC legislation is about finding intelligent information mechanisms and thus extending the area of party autonomy (see below 6). Information is even an overriding principle in core internal market issues such as the interplay between legal orders (see below 7).

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2. Introducing the topic: The role of party autonomy in the internal market

Few topics are as important for contract law as party autonomy,¹ probably none as characteristic for its image. Contract law is the core area not only for private law, but also of the internal market process.² This can be explained by the fact that the fundamental freedoms are the basic tools of the Treaty in this process³ and that they are designed to extend party autonomy across borders.⁴ The contract is the instrument of party autonomy. In the internal market, party autonomy means not only orthodox contractual freedom, but also and even more importantly, the freedom to choose the law applicable and thereby also to do away with domestic mandatory law (Art. 3 Rome Convention). Among

1. See e.g. Atiyah, "Contract and fair exchange" in id., *Essays on Contract* (Clarendon Press, 1986), p. 329; Atiyah, *The rise and fall of the freedom of contract* (Clarendon Press, 1979); Beale, "Inequality of bargaining power", 6 *Oxford Journal of Legal Studies* (1986), 123; Buckley (Ed.), *The fall and rise of freedom of contract* (Duke University Press, 1999); Thal, "The inequality of bargaining power doctrine – the problem of defining contractual unfairness", 8 *Oxford Journal of Legal Studies* (1986), 17; Gilmore, *The Death of Contract*, (Ohio State University Press, 1974) – which was translated into Italian as Ferri, *Il negozio giuridico fra libertà e norma* (Maggioli, 1987); v. Hayek, *Law, legislation and liberty – a new statement of the liberal principles of justice and political economy*, vol. 2, *the mirage of social justice*, (Routledge & Kegan Paul, 1976); in German literature: Bydlinski, *Privatautonomie und objektive Grundlagen des verpflichtenden Rechtsgeschäfts*, (Springer, 1967); Coester-Waltjen, "Die Inhaltskontrolle von Verträgen außerhalb des AGBG", 190 *Archiv für Civilistische Praxis* (AcP) (1990), 1; Fastrich, *Richterliche Inhaltskontrolle im Privatrecht* (Beck, 1992); Fikentscher, "Vertrag und wirtschaftliche Macht" in *Festschrift für Hefermehl* (1971), p. 41; Flume, "Rechtsgeschäft und Privatautonomie" in *Festschrift für Deutscher Juristentag* (1960), p. 135; Lorenz, *Der Schutz vor dem unerwünschten Vertrag* (Beck, 1997); Raiser, "Vertragsfunktion und Vertragsfreiheit" in *Festschrift für Deutscher Juristentag* (1960), p. 101; Rittner, "Über das Verhältnis von Vertrag und Wettbewerb", 188 *AcP* (1988), 101; Wolf, *Rechtsgeschäftliche Entscheidungsfreiheit und vertraglicher Interessenausgleich* (Keip, 1970).

2. Grundmann, *Europäisches Schuldvertragsrecht – das Europäische Recht der Unternehmensgeschäfte (nebst Texten und Materialien zur Rechtsangleichung)* (de Gruyter, 1999), provides comprehensive commentaries to the 40 most important legal measures with a substantial systematic introduction to the whole discipline and each sub-area; an English edition will be published by de Gruyter in 2003. The very first pioneer was Quigley, *European Community Contract Law* (Kluwer, 1997), providing, among other things, very helpful shorter commentaries on the relevant case law of the Court of Justice, and with less emphasis on developing a systematic part; see also Grundmann, "The structure of European contract law", (2001) *European Review of Private Law*, 505; before that, attention was given to the subject by Basedow, "A common contract law for the common market", 33 *CML Rev.* (1996), 1169; Heiss, "Europäisches Vertragsrecht in statu nascendi?", 36 *Zeitschrift für Rechtsvergleichung* (1995), 54; Kirchner, "Europäisches Vertragsrecht" in Weyers (Ed.), *Europäisches Vertragsrecht* (Nomos, 1997), p. 103.

3. The internal market definition is based to a great extent on the fundamental freedoms, and these are listed at the top of the list of objectives: Art. 3(1) lit. a and c and Art. 4(1) EC.

4. Müller-Graff, "Europäisches Gemeinschaftsrecht und Privatrecht – das Privatrecht in der europäischen Integration", (1993) *NJW*, 13, 14.

the fundamental freedoms, those related to contracts are more important, both practically and doctrinally, than those related to organization. These are the freedom of movement of goods, the freedom to provide services and of capital movements (Arts. 28, 49, 56 EC).

By European Contract Law, we mean the existing Community regulation (*lex lata*) concerning formation, content and termination of contracts. In national contract law, party autonomy dominates and the limits are seen as exceptions. However, the trend in the 20th century has been interpreted as entailing an erosion of party autonomy.⁵ Although there are distinct detailed trends in the different European legal orders, there are typically three types of limits. Probably the least important are the general clauses, mainly *bona mores*.⁶ Apart from these, there is regulation restraining party autonomy for a common good, mostly economic, and regulation for the protection of consumers. Common goods are, for instance, the stability of a currency which may be protected by a prohibition of index clauses,⁷ or undistorted competition, which is protected by a prohibition of cartels.

Party autonomy is becoming an important issue of European contract law. This is due to the fact that the general clauses are the only ones remaining predominantly within the preserve of national law⁸ and that the other two types of limits, which are to be found at the European level, are more important. These two types concern mass transactions – stereotypes for groups of transactions and of persons. For these two kinds of limits, the key decisions have now

5. E.g. Atiyah, Gilmore and v. Hayek, *supra* note 1; Kramer, *Die "Krise" des liberalen Vertragsdenkens – eine Standortbestimmung* (Fink, 1974); seeing the opposite tendency, Buckley, *supra* note 1.

6. See, also for the distinctions in the text, Kötz, *Europäisches Vertragsrecht, Bd. I: Abschluß, Gültigkeit und Inhalt des Vertrages – die Beteiligung Dritter am Vertrag* (Mohr, 1996), p. 189–209.

7. On these clauses, see Wood, *Law and Practice of International Finance – International Loans, Bonds and Securities Regulation*, 2nd ed. (Sweet & Maxwell, 1995), p. 80–92.

8. *Bona mores* and good faith as a limit have only been taken up in Community law very rarely, as a basic principle mainly in the unfair contract terms directive (Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, O.J. 1993, L 95/29), moreover in Art. 3(1) and Art. 4(1), Council Directive 86/653/EEC of 18 Dec. 1986 on the coordination of the laws of the Member States relating to self-employed commercial agents, O.J. 1986, L 382/17. *Bona mores* and good faith may, however, be applicable as a general principle limiting rights conferred by any Community measure: see e.g. Case 44/59, *Fiddelaar*, [1960] ECR 535 at 547; Case 71/83, *Russ*, [1984] ECR 2417 at 2431 and 2433; see Collins, "Good faith in European contract law", 14 *Oxford Journal of Legal Studies* (1994), 229, esp. 249–254; Meyer, *Bona fides und lex mercatoria in der europäischen Rechtstradition* (Wallstein, 1994); Zimmermann and Whittaker (Eds.), *Good faith in European Contract Law – the Common Core of European Private Law* (Cambridge University Press, 2000); justifying the application of general principles in this respect, Grundmann, "General principles of private law and *ius commune modernum* as applicable law?" in *Festschrift for Buxbaum* (2000), p. 213.

largely been transplanted to the European level.⁹ National rules without an origin in European law measures typically do not regulate market failure, i.e. structural shortcomings of the functioning of markets, but individual cases, mostly extraordinary weaknesses of a few persons (low capacity in one way or another). Therefore, the importance of the topic for European contract law resides, first, in the fact that the *bulk of regulation* has *shifted from national to European law*.¹⁰

A second reason has to do with the functioning of the fundamental freedoms. As long as they were used to restrict national regulation, Community law had mainly deregulatory and liberalizing effects. This was no longer evident once re-regulation, on the basis of harmonization, started. However, contrary to widespread belief, even in European re-regulation, there are *strong mechanisms against unduly heavy restrictions on party autonomy*. This is even a general characteristic of European contract law. This trend towards strengthening a “private law society” (“*Privatrechtsgesellschaft*”) has to be discussed. This goes so far as to allow private regulators to compete with public regulators in many situations.¹¹

3. Information rules and substantive mandatory law – status quo in the internal market

Discussion of the topic as a whole has to be based on the status quo: what kind of mandatory rules are to be found in European private and contract law and to what extent? Indeed, many authors see the fact that European contract

9. Survey by Grundmann, *supra* note 2, p. 56–67; also Quigley *op. cit. supra* note 2.

10. There is no monograph on this topic yet, but see the papers (both by economists and lawyers from several countries) in Grundmann, Kerber and Weatherill (Eds.), *Party Autonomy and the Role of Information in the Internal Market* (de Gruyter, 2001); and in Italian in Alessi (Ed.), *Diritto europeo e autonomia contrattuale* (G. Giappichelli, 2000). The topic is also important in company law. See e.g. Grundmann, “Information und ihre Grenzen im Europäischen und neuen englischen Gesellschaftsrecht” in *Festschrift for M. Lutter* (2000), p. 61; the English company law reform is based very much on this assumption: *Modern Company Law – For a Competitive Economy – The Strategic Framework – A Consultation Document from the Company Law Review Steering Group*, (2/1999), p. 12, 15, 46 et seq., 49 et passim; *Modern Company Law – For a Competitive Economy – Developing the Framework – A Consultation Document from the Company Law Review Steering Group*, (3/2000), p. 8, 151 et seq., 49 et passim.

11. As argued by both Kerber and Kirchner, in Grundmann (Ed.), *Systembildung und Systemlücken in Kerngebieten des Europäischen Privatrechts – Gesellschaftsrecht, Arbeitsrecht, Schuldvertragsrecht* (Mohr, 2000), the one at p. 67, 91–96, the other at p. 99, 111 et seq.; dogmatically this postulate can be based on the fundamental freedoms, at least within the Community, see Grundmann, “Law merchant als *lex lata* Communitatis – insbesondere die Unidroit-Principles” in *Festschrift for W. Rolland* (1999), p. 145, 146–154 and *id. op. cit. supra* note 8, 216.

law is mandatory as its key feature.¹² This is questionable, at least if this means mandatory rules imposing substantive solutions. Two areas have to be distinguished in European contract law, as two different directorates-general are responsible for them and, with respect to the topic discussed here, the approaches differ quite considerably.

3.1. *Financial services*

Financial services are dealt with by the directorate general for the internal market (formerly DG XV). In this area, the split between the two types of mandatory rules named is evident and this split is characteristic not only of European contract, but also company law. Here, there is a *clear preponderance of information rules*, for instance disclosure rules. Information rules prescribe the giving of information to the less well-informed party and as such these rules can be termed mandatory. They are different from mandatory rules prescribing solutions in substance, in that they leave the choice in substance again to the parties' autonomy. This preponderance can best be illustrated by identifying the content of all important Community measures in the field.

Historically the core act in financial services, the *Consumer Credit Directive* 1986,¹³ contains only information rules in Articles 3–6. These rules prescribe for different phases (publicity, pre-contract phase, contract) the giving of information on the two key parameters: the annual percentage rate and the total costs of the credit. The first type of information enhances transparency of the “price”, the key parameter for competition in this type of contract, and through that competition the supply of consumer credit. Complex data in life are added and transformed via a uniform formula into one simple figure which can be easily understood. The second type of information helps the client to see whether he or she, individually, can afford the credit. Altogether the two key elements as to the product and as to its suitability for the client have to be made transparent. Articles 7–11 on the other hand, contain substantive mandatory rules only on some specific points. For example, the client has the right to discharge before the time fixed; if the creditor recovers possession of an item financed, the credit terminates in order to avoid the client having to pay without having the benefit of use. In case of certain pre-existing agreements

12. E.g. Schiemann, “EG-rechtliche Haftung für Dienstleistungen”, in Schnyder, Heiss and Rudisch (Eds.), *Internationales Verbraucherschutzrecht – Erfahrungen und Entwicklungen in Deutschland, Liechtenstein, Österreich und der Schweiz* (Mohr, 1995), p. 131, 134; or Kirchner, *supra* note 11, p. 99, 111.

13. Council Directive 87/102/EEC of 22 Dec. 1986 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit, O.J. 1987, L 42/48; amended in O.J. 1990, L 61/14 and O.J. 1998, L 101/17.

between creditor and seller, rights against the seller also operate against the creditor.

Equally important for the fund transfer business is the *Payments Directive*.¹⁴ Articles 3–7 again contain information rules for the two key parameters, costs and execution time, as well as sanctions. Giving no information or false information triggers default or liability rules. Only Article 8 contains a mandatory rule prescribing a certain substance for the contract, not merely the giving of information. This is the money-back-guarantee, under which the first bank has to compensate the client (up to a certain amount) if the money is lost in the transfer chain.

Equally important for the third core banking business, investment banking, is the *Investment Services Directive* (ISD).¹⁵ Only Article 11 concerns the contractual relationship, though responsibilities here have repercussions on the organizational duties (Art. 10). Article 11(1), phrase 4 regulates the duties which investment banks owe their clients quite intensively. They fall into three categories: indents 1–3 contain the duty of loyalty and the duty of care and a clarification of some particular aspects of that duty of care. If the client takes the investment decision him- or herself, i.e. if it is not the bank that manages the portfolio, these duties only serve as a specification of the core duty in this respect. In this case, the bank has to comply with its duty of care and of loyalty when giving information and advice, as well as when executing the subsequent order. The duty to give information is then contained in indents 4 and 5 and is the core duty. Under European law (as under German and English law) the client can always take the investment decision himself, which is seen as the typical constellation. Again, the bank has to give information as to the financial instrument (product) and to the suitability for the particular client (the “know your customer” principle).

The Directive is quite specific in this respect and states that all “material” information has to be given, and must be given in an “appropriate”, i.e. understandable, way. The duty to give information is formulated here in a more generic way because the range of relevant facts is much wider in investment banking. The third duty – the duty to avoid conflicts of interests and thereby the very danger of not acting with fairness once the conflict arises – is linked to an information rule as well. In a universal bank system, such conflict often cannot be avoided. Then it has at least to be disclosed.

14. European Parliament and Council Directive 97/5/EC of 27 Jan. 1997 on cross-border credit transfers, O.J. 1997, L 43/25.

15. Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field, O.J. 1993, L 141/27; amended in O.J. 1995, L 168/7.

Therefore, there is also a preponderance of information rules in investment banking regulation.¹⁶

As far as contract law goes, the *Insurance Directives* – life and non-life –¹⁷ introduced nothing but information rules and rules on conflicts of laws. So far, however, only in life insurance is information on all material issues required. These information rules were not, however, considered to be sufficient to admit freedom of choice of law (outside the area of large risks). Such freedom seems to exist, though, where the client establishes the contact with a foreign insurance abroad and on his own initiative (“active client”).¹⁸ Again, information rules dominate, even though the freedom of choice of law is reserved only for the active client.

3.2. *Remaining areas*

The general approach differs considerably in the legal measures proposed by the Directorate General for Health and Consumer Protection (formerly DG XXIV). These are primarily the Unfair Contract Terms and the Sales Directive(s). In addition, concerning formation, we must consider the Door Step and Distance Selling Directive(s), and, concerning mainly contract contents, we will look at the Package Travel and Timesharing Directive(s).

The *Unfair Contract Terms Directive*¹⁹ is mainly concerned with the control of standard terms, i.e. a substantive mandatory rule. The reason for imposing such a solution is, however, to be found in information economics. Unavoidable and incurable information asymmetries are the source of a type of market failure, first described by Akerlof, which is essentially undisputed today. Gathering information is much more costly for a client who concludes one type of standard term contract (often only once), than it is for a business

16. This regulation is supplemented by the insider dealing directive 89/592/EEC (O.J. 1989, L 334/30). The insider dealing prohibition has been condensed very convincingly into the formula: “disclose or abstain”.

17. In both cases these rules were introduced in the second and third generation of directives. See references (also for literature) in Grundmann op. cit. *supra* note 2, 4.30–1/2/3 and 4.31–1/2/3 “*Fundstellenverzeichnisse*”; Quigley, op. cit. *supra* note 2, p. 310–321. See also the references for the block exemption for the insurance sector, which also concerns standard term insurance contracts.

18. This is disputed, although it was clear for the second generation of directives. And the Community legislature made it explicit that the third generation should extend, not restrict, liberalization. See Grundmann, *supra* note 2, 4.31 para. 18–21 (commenting on the whole conflicts of laws system); Hübner and Matusche-Beckmann, “Auswirkungen des Gemeinschaftsrechts auf das Versicherungsrecht”, 6 EuZW (1995), 263, 266; the opposite view is taken by Smulders and Glazener, “Harmonization in the field of insurance law through the introduction of Community rules of conflict”, 29 CML Rev (1992), 775, 793–795.

19. Cited *supra* note 8.

partner who uses it for all transactions and thus splits his costs innumerable times. The asymmetry is such that it cannot be cured. This justifies a mandatory substantive rule.²⁰

The *Door Step and the Distance Selling Directives*²¹ contain mainly a right to revoke the contract within a short period after formation of the contract. This gives the client the possibility to inform him- or herself about competing offers and to think about the suitability of the contract without pressure (cooling-off period) – a possibility which had been taken from him by the particular type of marketing mechanism. Therefore the revocation right also has to be interpreted basically as an information right.²² The normal market mechanism (with the opportunity to compare prices) is restored. The rule does not replace market forces. It does not forbid, for instance, any marketing techniques. Apart from the directives mentioned there are pre-contractual information rules in many Directives, and there is – although not contract law strictly speaking – the Directive on misleading advertising.²³

Information rules are also part of a number of *other measures*, but do not dominate them. This is so with the Package Travel Directive, the Timesharing Directive,²⁴ and also in labour law, where there is one Directive extending the general information paradigm to labour contracts as well.²⁵ Finally, the *Sales*

20. See in more detail Adams, “Ökonomische Begründung des AGB-Gesetzes – Verträge bei asymmetrischer Information”, 44 BB (1989), 781, 787; and, from an economic perspective, Schäfer and Ott, *Lehrbuch der ökonomischen Analyse des Zivilrechts*, 3rd ed. (Springer, 2000), p. 478–480.

21. Council Directive 85/577/EEC of 20 Dec. 1985 to protect the consumer in respect of contracts negotiated away from business premises, O.J. 1985, L 372/31; European Parliament and Council Directive 97/7/EC of 20 May 1997 on the protection of consumers in respect of distance contracts, O.J. 1997, L 144/19. Financial services are excluded in both cases. For life insurance (*supra* note 17), however, there is a revocation right irrespective of the form of marketing. And for distance selling there is a separate proposal for a directive on financial services; see O.J. 1998, C 385/10, COM(98) 468 final.

22. For discussion, *inter alia* from the perspective of information asymmetry, see Rekaiti and van den Bergh, “Cooling-off periods in the consumer laws of the EC Member States – a comparative law and economics approach”, 23 *Journal of Consumer Policy* (2000), 371.

23. Council Directive 84/450/EEC of 10 Sept. 1984 relating to the approximation of the laws, regulations and administrative provisions of the Member States concerning misleading advertising, O.J. 1984, L 250/17; amended in O.J. 1997, L 290/18 (now including comparative advertising). For a comparative law survey (including transposition) see Schotthöfer (Ed.), *Handbuch des Werberechts in den EU-Staaten einschließlich Norwegen, Schweiz, Liechtenstein und USA*, 2nd ed. (Schmidt, 1997).

24. Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours, O.J. 1990, L 158/59; European Parliament and Council Directive 94/47/EC of 26 Oct. 1994 on the protection of purchasers in respect of certain aspects of contracts relating to the purchase of the right to use immovable properties on a timeshare basis, O.J. 1994, L 280/83.

25. Council Directive 91/533/EEC of 14 Oct. 1991 on an employer’s obligation to inform employees of the conditions applicable to the contract or employment relationship, O.J. 1991,

Directive leaves considerably more leeway to (informed) party autonomy than many authors believe.²⁶ The rules about whether the goods have attained the standard required – and this is the starting point – are basically information rules. If the seller discloses the quality properly, he or she is free to offer any quality. It is only to the rest of the regulation in this Directive, and only to the relationship between consumer and retailer, that Article 7 applies, which imposes mandatory substantive solutions. This mainly concerns the rights conferred upon the customer once a breach of the required standard is ascertained.²⁷ To conclude, information rules dominate financial services and are still strong in the other areas.

4. Restriction of competition and information asymmetries as the main types of market failure

The discussion also has to take into account the theory behind the question discussed, i.e. the theory of markets and market failure, refined for our specific purposes in information economics. The one set of terms is party autonomy and market freedom, the other is limits to party autonomy and market failure to be remedied by (State or Community) regulation. Regulation, i.e. State intervention into market freedom, has been justified since the development of ordoliberal thinking by identifying a case of market failure. This is still basically accepted in economics today, especially in institutional economics as the core branch for an economic analysis of legal rules (“institutions”).²⁸

L 288/32. For a survey on European labour law, see Barnard, *EC Employment Law*, 2nd ed. (OUP, 2000); Bercusson, *European Labour Law*, 2nd ed. (Butterworths, 2000); Blanpain and Engels, *European Labour Law*, 8th ed. (Kluwer, 2002). For the information paradigm in this area, see the contributions by Collins and by Deakin to Grundmann, Kerber and Weatherill, *supra* note 10, p. 205 and 371.

26. European Parliament and Council Directive 1999/44/EC of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees, O.J. 1999, L 171/12; and COM(95) 520 final. See more in detail Van Gerven and Stijns commentary to Art. 7 in Bianca and Grundmann (Eds.), *EU Sales Directive – Commentary* (Intersentia/Hart, 2002); Grundmann, in Grundmann, Medicus and Rolland (Eds.), *Europäisches Kaufgewährleistungsrecht – Reform und Internationalisierung des deutschen Schuldrechts* (Heymanns, 2000) p. 281, 297 et seq. and Riesenhuber, *infra* note 27.

27. For an interesting analysis of this situation as an information problem which can only be solved by mandatory law, see Riesenhuber, “Party autonomy and information in the sales directive” in Grundmann, Kerber and Weatherill, *supra* note 10, p. 348.

28. See Furubotn and Richter, *New institutional economics – an introduction and critical appraisal*, 2nd ed. (University of Michigan Press, 1998), p. 299 et seq. (or other forms of social organization); Fritsch, Wein and Ewers, *Marktversagen und Wirtschaftspolitik*, 3rd ed. (Vahlen, 1999), p. 91–304; Schwartz, “Legal implications of imperfect information in consumer markets”, 151 *Zeitschrift für die gesamte Staatswissenschaft – Journal of Institutional and Theoretical Economics* (JITE) (1995), 31, 31.

This is of central importance for the internal market, as ordoliberal thinking has shaped the economic constitution of the EC. Among the various kinds of market failure²⁹ two have proved to be of particular importance in European contract law: restriction of competition and information asymmetries.³⁰

4.1. *Undistorted competition as the internal market paradigm*

In ordoliberal thinking, the first form of market failure – restriction of competition – was predominant. For Eucken, State order in free markets equalled a “competition order” (“*Wettbewerbsordnung*”).³¹ Competition law was the only substantive law to be regulated in the Treaty itself (today Arts. 81–86 EC) and not be postponed to secondary legislation (with Community competences even in administration). Moreover, it was supplemented by important institutions which were hitherto unknown, mainly those binding even States to competition standards (State enterprises; law on State aids and later, mainly in secondary law, on public procurement).

Competition law *stricto sensu* is only one side. Undistorted competition is the paradigm of the internal market, and goes far beyond narrow competition law. All fundamental freedoms are based on it³² and, today, this paradigm also influences those authors who postulate competition of regulators or legal ideas in Europe.³³

29. See e.g. Fritsch, Wein and Ewers, *op. cit. supra* note 28.

30. The third major form of market failure, externalities, are of little importance here. This is so because of privity of contracts. This is different only with respect to restriction of competition, which may also be a case of externalities but is normally treated separately.

31. Eucken, *Grundsätze der Wirtschaftspolitik*, 6th ed. (Mohr, 1990), p. 241 et seq.

32. See not only Art. 28, 39, 43, 49, 56, but also Art. 97 et seq. EC; and e.g. Epiney, “Art. 28(3)” in Callies and Ruffert (Eds.), *Kommentar zum EU-Vertrag und EG-Vertrag* (Luchterhand, 1999).

33. Bratton, McCahery, Picciotto and Scott (Eds.), *International Regulatory Competition and Coordination – perspectives on economic regulation in Europe and the United States* (Clarendon, 1996), p. 127, 140; Charny, “Competition among jurisdictions in formulating corporate law rules – an American perspective on the race to the bottom in the European Communities”, 32 *Harv. Int’l L.J.* (1991), 423; Hauser and Hösli, “Harmonization or regulatory competition in the EEC (and the EEA)”, 46 *Aussenwirtschaft* (1991), 497; see Kerber, *supra* note 11, p. 67, 91–96; Kerber, “Interjurisdictional competition within the European Union”, 23 *Fordham Int’l L.J.* (2000), S217; Siebert and Koop, “Institutional competition – a concept for Europe?”, 45 *Aussenwirtschaft* (1990), 439; Sun and Pelkmans, “Regulatory competition in the Single market”, 33 *JCMS* (1995), 67; Vanberg and Kerber, “Institutional competition among jurisdictions – an evolutionary approach”, 5 *Constitutional Political Economy* (1994), 193; Woolcock, *The Single European Market – Centralization or Competition among National Rules* (Royal Inst. of Internat. Affairs, 1994), p. 20–24.

4.2. Information as an instrument to foster party autonomy

4.2.1. Information asymmetries: A problem for party autonomy

For this paper, a second form of market failure is still more important. This form may have a direct impact on virtually any type of contract, not only contracts concluded by public authorities and enterprises which are able to restrict competition. This form of market failure is omnipresent not only in European contract law, but also in company law. This is information asymmetry.

Information on the relevant parameters is a condition for rational wealth-maximizing decision-making and thus for the functioning of markets. However, *not every information asymmetry* is negative. The fact that information can be distributed asymmetrically constitutes the key incentive for producing information and is indispensable for the selection process in markets. Information asymmetries are problematic only if one side cannot overcome them, or only at excessive costs. In these cases, one side unavoidably acts on too narrow an information basis: the market structure is defective unless the information basis is equalized. For the moment, we leave open whether and when this task can be left to the markets or whether the regulator has to step in and prescribe mandatory disclosure.

The *mechanism of market failure* in case of information asymmetries has been described in the 1970s: if the demand side cannot judge the quality of offers (goods, services, contract conditions) it can only evaluate the offer according to prices. It will evaluate the offer at most at average price or rather below it. Offers of high quality do not reach higher prices. The (additional) costs for quality will not be compensated. In this case not only will demand not distinguish between good and bad offers, but good offers are systematically driven out of the market. There is a race to the bottom, a market that produces more and more “lemons”. When describing the phenomenon in 1970 Akerlof called it the “market for lemons”.³⁴

Today, if there are enough competitors in a market, unequal bargaining power of consumers and sellers, i.e. the so-called *consumer contract law*, is explained as being founded on a *problem of information asymmetries*.³⁵ One side in the market possesses considerably more relevant information because

34. Akerlof, “The market for ‘lemons’: Quality uncertainty and the market mechanism”, 84 *Quarterly Journal of Economics* (1970), 488; today Emons, “Warranties, moral hazard, and the lemons problem”, 46 *Journal of Economic Theory* (1988), 16; Fritsch, Wein and Ewers, *supra* note 28, p. 262–269; also Furubotn and Richter, *supra* note 28, p. 236–241.

35. Fleischer, *Informationsasymmetrie im Vertragsrecht* (Beck, 2001); Kerton and Bodell, “Quality, choice and the economics of concealment – the marketing of lemons”, 29 *Journal of Consumer Affairs* (1995), 1, esp. 20–24; Schäfer, “Grenzen des Verbraucherschutzes und adverse Effekte des Europäischen Verbraucherrechts” in Grundmann, *supra* note 11, p. 559, 559–564; Schwartz, *op. cit. supra* note 28, 35–46; Strassner, *Verbraucherinformationsrecht – rechtliche Grundlagen und rechtsökonomische Aspekte* (ÖR-Verlag, 1992), p. 126–136.

it acts professionally in the market, or because it created the product. In the national legislation of many western countries this has been discussed in relation to standard contract terms.³⁶ The gathering of information is excessively costly for those players in the market who use it only occasionally, because they have to allot the costs to far fewer transactions. Therefore, the difference in costs between the two sides of the market is particularly high where there is particular professional knowledge. The distribution of information is structurally asymmetric. This is not necessarily the case only for private consumers. Indeed, about half of the legal measures in European contract law are also applicable to and in favour of professional clients. In financial services, this is so in all cases but one. If the asymmetric distribution concerns information relevant for the contract, the contract mechanism is no longer a guarantee for normally adequate results (“*Richtigkeitsgewähr*”). Levelling the information positions in the parameters relevant to the transaction becomes necessary – if all else fails, by State intervention.

4.2.2. *Information rules – often mandatory, but aimed at party autonomy*

Information rules in European contract and company law are mostly mandatory. Disclosure of the relevant parameters is not left to the choice of the parties. Two aspects are of interest.

On the one hand, there is an *important difference* between *mandatory information rules* and *mandatory substantive rules*. The latter reduce variety – either to one possibility only or to a smaller range of possibilities (typically in unfair contract terms law). Markets such as the German insurance market seem to show that this often has cartellizing effects. Still more important for the topic discussed here: reducing variety means reducing offers which match individual preferences. Individual preferences, however, are nowadays the basic point of reference for economic theory-building (normative individualism).³⁷ A substantive mandatory rule can be justified only if an information rule cannot remedy the market failure. This is so because information rules may be mandatory by construction (the duty to disclose is not subject to party autonomy), but they are always aimed at enabling the parties

36. See comparative survey on different approaches in different Member States to controlling standard term contracts: COM(90) 322 FIN – SYN 285, p. 6–64; v. Hippel, 41 *RabelsZ* (1977) 237, (expert opinion for the Commission); Kötz, *supra* note 6, p. 211–220.

37. Furubotn and Richter, *supra* note 28, p. 3; and more in detail Schäfer and Ott, *supra* note 20, p. 55–69. From a constitutional law perspective it has been argued convincingly that consumers may not be restricted unduly in the freedom of choice, also with regard to product variety: Drexler, *Die wirtschaftliche Selbstbestimmung des Verbrauchers – eine Studie zum Privat- und Wirtschaftsrecht unter Berücksichtigung gemeinschaftsrechtlicher Bezüge* (Mohr, 1998), p. 217–280.

to take an autonomous decision in substance.³⁸ The full range of varieties matching preferences remains open.

On the other hand, many authors *doubt that information rules have to be mandatory*.³⁹ Informing the demand side is seen as a competition parameter in the long run. The argument runs that sellers offering better products or conditions have an interest in informing the market, and that the shaping of information is then more flexible than under uniform State disclosure rules. Empirically, however, information markets have not proven to be very efficient. Costs and execution time of cross border fund transfers were not disclosed before the coming into force of the Directive. Consumer credit markets were not transparent before EC rules were enacted. Insurance companies do not seem to be interested in high market transparency. Stereotyping the information to be disclosed is not such a disadvantage if it is fairly clear which information is relevant to the transaction (fund transfers, consumer credits, etc.). Otherwise there is enough flexibility if “material information” has to be disclosed, the best offer being clearly more visible if all parts of the market have to disclose in the same standardized way. In all this, State or EC disclosure rules have advantages, especially if a bigger market is still in *statu nascendi*.

5. Supremacy of party autonomy over substantive mandatory law under the EC Treaty

The EC Treaty and the fundamental freedoms constitute a primary framework for an information model in European private law.

5.1. *The Cassis de Dijon case law*

Few decisions of the European Court of Justice had such effect as that in *Cassis de Dijon* of 1979.⁴⁰ Even the minimum harmonization approach, preferred since 1985 and for the internal market, was mainly based on it.⁴¹ Moreover,

38. In this sense see also Schwartz, op. cit. *supra* note 28, 32.

39. An in-depth discussion is impossible here. See, in more detail, Hadfield, Howse and Trebilcock, “Information-based principles for rethinking consumer protection policy”, 21 *Journal of Consumer Policy* (1998), 131, esp. 141–150; Gertner and Fishman and Hagerty, “Disclosure and Unravelling” and “Mandatory Disclosure” in Newman (Ed.), *The New Palgrave Dictionary of Economics* (Macmillan, 1998).

40. Case 120/78, *Cassis de Dijon*, [1979] ECR 649.

41. Completing of the Internal Market – White paper of the Commission to the European Council, COM(85) 310 final, p. 18 et seq., 27 et *passim*; see Hayder, “Neue Wege der europäischen Rechtsangleichung – die Auswirkungen der Einheitlichen Europäischen Akte von

this judgment is the basis for a European information model.⁴² The Court based the judgment on the fundamental freedoms and the principle of proportionality inherent to them:⁴³ if a national legislature can attain its objective by prescribing information to be supplied to the person to be protected, the *mere information rule has to be preferred to a substantive mandatory rule*, a command or prohibition. Germany intended to protect purchasers of liquors from being cheated by prescribing a minimum percentage of alcohol in them. The Court held that simply informing the clients by way of labelling was sufficient. The case law acts here as a *negative standard*: it excludes certain types of national rule setting, i.e. certain national mandatory rules. The same holds, however, for the Community legislature.⁴⁴

The factual situation was such that postulating the supremacy of an information rule was particularly convincing in the case. The *conditions for an information model* were absolutely fulfilled. On the one hand, the information to be given was not so complex that the other side had to incur considerable transaction and information costs. The party to be protected could process the information easily and take a meaningful decision on its basis. On the other hand, this information could be used for a decision in total freedom. Both conditions – meaningful information and freedom of choice – can be problematic in certain cases in company law. In contract law typically only the former.

5.2. The public procurement case law

Some judgments on public procurement concern a second aspect. On the basis of the fundamental freedoms, they develop a duty of public authorities to inform (potential) bidders. Fundamental freedoms then act as a *positive*

1986", 53 RabelsZ (1989), 622, esp. 632–634; Bruha, "Rechtsangleichung in der Europäischen Wirtschaftsgemeinschaft – Deregulierung durch 'Neue Strategie'", 46 ZaöRV (1986) 1, 7 et seq., 10 et seq., 12 et seq.

42. See e.g. Commission, "Consumer policy – second commission three-year plan 1993–1995 – placing the single market at the service of European consumers", COM(93) 378 final, p. 16: "Information is essential if the consumer is to enjoy the advantages of the single market."

43. For the proportionality principle see Art. 5(2) EC; Case C-233/94, *Germany v. European Parliament and Council*, [1997] ECR I-2405, 2459–2462; Case C-97/95, *Pascoal*, [1997] ECR I-4209, 4255–4258; De Búrca, "The principle of proportionality and its application in EC law", 13 YEL (1993), 105, 114–126; Emiliou, *The Principle of Proportionality in European Law – a comparative study* (Kluwer, 1996). One aspect is that consumers may not be restricted unduly in the freedom of choice, also as to product variety: see Drexler, *supra* note 37, p. 217–280.

44. Joined Cases 80/77 and 81/77, *Commissionaires Réunies and Fils de Henri Ramel*, [1978] ECR 927, 944–947; Case 41/84, *Pinna*, [1986] ECR I, 25 (implicitly); Case C-341/95, *Bettati*, [1998] ECR I-4355, 4380 et seq.; cf. the monographs by Scheffer, *Die Marktfreiheiten des EG-Vertrages als Ermessensgrenzen des Gemeinschaftsgesetzgebers* (Lang, 1997); and Schwemer, *Die Bindung des Gemeinschaftsgesetzgebers an die Grundfreiheiten* (Lang, 1995).

standard⁴⁵ and they impose duties on a party to the contract. This has a re-regulatory effect.

The basic problem in public procurement was that its share in the EU gross income is about 11.5%, a huge industry, but that contracts were allotted to foreign bidders in less than 1% of all cases.⁴⁶ For many different reasons, it often occurred that the best offer (in quality or price) was not chosen, but reasons pertaining to the bidder were decisive, often discriminating against foreign bidders.⁴⁷ Already in the late 1980s, the Cecchini report estimated the harm caused to public treasuries and the economy in the EU as being near 15 billion Euro a year.⁴⁸ *Information rules help to prevent discrimination.* Hidden discrimination is also forbidden and there are many forms. A public authority can insist on domestic security standards even though foreign standards are equivalent.⁴⁹ Or it can ask that a certain share of the turnover of the bidder be made in the region.⁵⁰ Hidden discrimination is possible, *inter alia* if the public authority gives information only to domestic bidders or on occasions where typically only domestic bidders are present or in local media. The same is true for cases in which the authority specifies security standards according to domestic terminology, thus creating higher information costs for foreign bidders. All these practices led to the introduction of a genuinely European publication tool for public procurement, which has to be used to inform all bidders at the same cost and very early.⁵¹

45. One problem of interpreting the decisions is that most of them are based on the fundamental freedoms *and* on the rules in the directives: Case 76/81, *Transporoute*, [1982] ECR 417, 428; Case 45/87, *Dundalk*, [1988] ECR 4929, 4962–4965; Case C-21/88, *Mezzogiorno*, [1990] ECR I-889, 919 and 921.

46. COM(96) 583 final, p. 9 (720 billion ECU); European Commission – Eurostat, *Panorama of EU Industry 97*, 2 vols.: *an extensive survey on the situation and the perspectives for the sectors of industry and services in the European Union*, (1997), p. 38. In the early 1990s only 0.14% of public procurement was ordered cross border: Cecchini, *Europe 92 – the advantage of the internal market* (EC Office of official publications, Brussels, 1988), p. 37.

47. Business cycle, regional and sectoral policies, but also outright nepotism, see e.g. Arrow-smith, "Public procurement as an instrument of policy and the impact of market liberalization", 111 *Law Quarterly Review* (1995), 235; or from an economic point of view Gandenberger, "Öffentliche Auftragsvergabe" (sub D), in *Handwörterbuch der Wirtschaftswissenschaften*, vol. 5 (Fischer, 1988), p. 405, 411 et seq.

48. *Supra* note 46, Cecchini, p. 37–39; and even higher: EC Commission, *Vademecum*, O.J. 1987, C 358/1 (1) (half of the Community budget).

49. *Dundalk*, cited *supra* note 45, 4964 et seq.

50. Case C-360/89, *Commission v. Italy*, [1992] ECR I-3401, 3420; for regional preferences, see already Case C-21/88, *Mezzogiorno*, [1990] ECR I-889, 919–922.

51. Publication is made primarily on the electronic data base TED (Tenders Electronic Daily) which is run by the Community and thus provides the information Community-wide in one standard way: see Art. 9(6) of the Council Directive 93/36/EEC of 14 June 1993 coordinating procedures for the award of public supply contracts, O.J. 1993, L 199/1; amendment in O.J. 1997, L 328/1 (and Adhesion Acts); parallel rules are always to be found in the directives on public works and public service contracts; however, with respect to TED also the fourth

5.3. The Centros case law

A third line of cases transposes the *Cassis de Dijon* reasoning to *company law* and the freedom of establishment. Here too, the Court has opted for an *information model* since 1999. In the *Centros* case,⁵² the Court upheld the choice of another law for questions of minimum capitalization, although the host country wanted to apply its own law to the case. In the Court's view, the host country, Denmark, had not proved that mandatory reasons of public good justified an application of Danish law. The Court gave two reasons, each of them sufficient in itself. It decided that the mandatory reasons invoked had at least not been applied consistently. It then held, decisive in our context, that by using the firm of a private English (Limited) Company, Centros Ltd., it had made clear to the public that it disposed only of capital according to English law. And this did not necessarily include a fixed minimum capital. The Court thus gave supremacy to the English *information* rule inherent in the English registration process over mandatory Danish law regulating the substance, here minimum capitalization. With respect to an information model, the main difference with *Cassis de Dijon* seems to be that *information* of the persons to be protected, mainly creditors, was *more difficult*. It is easier to read the percentage of alcohol on a label than to find out that English law does not contain a minimum capitalization prerequisite. Much of the harsh criticism of the *Centros* judgment on the continent⁵³ may be due to this. However, the first impression is misleading. Stated capital has to be disclosed all over Europe in a particular register (Art. 2(1) lit. c and e and Art. 3 lit. b and c of the 1st and the 2nd Company Law Directives). The mechanism for finding the information is thus known to all creditors from their own country. Moreover, the result of the application of the law is a figure, and thus easy to understand. This register also contains the information that a company does not have a (minimum) capital at all. The only problem is that finding and consulting the register may be more difficult abroad. It is therefore plausible to ask here for a European register (as with public procurement), which contains the entries

directive runs parallel and contains the same rule in Art. 25: see Council Directive 93/38/EEC of 14 June 1993 coordinating the procurement procedures of entities operating in the water, energy, transport and telecommunications sectors, O.J. 1993, L 199/84, amended by Directive 94/22/EEC, O.J. 1994, L 164/3 and Directive 98/4/EC, O.J. 1998, L 101/1. See in general Arrowsmith, "E-commerce policy and the EC procurement rules: The chasm between rhetoric and reality", 38 CML Rev., 1447–1477.

52. Case C-212/97, *Centros*, [1999] ECR I-1459.

53. See e.g. Kegel, "Editorial: Something is rotten in the state of Denmark", (8/1999) *Europäisches Wirtschafts- und Steuerrecht – Betriebs-Berater für Europarecht* (EWS); less pungent, but also critical: Lutter, "Das Europäische Unternehmensrecht im 21. Jahrhundert", (2000) *Zeitschrift für Gesellschafts- und Unternehmensrecht* (ZGR), 1, 9.

made and checked in the national registers.⁵⁴ This shows that, contrary to current interpretation,⁵⁵ the 2nd Company Law Directive (Capital Directive) does not contain information rules only in Articles 2 and 3. The rules on stated capital – payment and evaluation of contributions – have to be interpreted as information rules as well. Because of these rules, the information given about stated capital has a standardized and uniform meaning, which makes it more transparent and reliable.⁵⁶

6. EC directives fostering party autonomy via information rules

An information model in European secondary law resides on two pillars. It must be possible to inform the protected party in a meaningful way, and the person must be able to react (freedom of choice). In European contract law only the first aspect is important, in European company law potentially also the second. If there is no freedom of choice an information rule typically cannot substitute a substantive mandatory rule. Freedom of choice may, however, also mean that of a third party, for instance the public's capacity to react. The following discussion will concentrate on the first aspect.

6.1. *Is meaningful information possible?*

6.1.1. *Simple information (search and observation goods)*

Information is meaningful if it enables the other party to take a rational wealth-maximizing decision: that party must receive the relevant information and be able to process it. According to economic theory, this is the case with search or observation goods.⁵⁷ Here, one can check the quality of the product through inspection. The equivalent is information which is certified, e.g. via inspection by a third and neutral party and/or sufficient liability rules. Rules which bring about this simplest status of information, i.e. rules which *transform goods into search goods* can be found in European contract law under labelling provisions. Revocation rights also have to be referred to: goods which had

54. Lutter, *supra* note 53, at 10.

55. Dorresteyn, Kuiper and Morse, *European Corporate Law* (Open University, Faculty of Law, 1994), p. 40; Lutter, *supra* note 53, at 3 and 10.

56. See Grundmann (2000), *supra* note 10, for more detail on all these questions and considering *Centros* from an information perspective.

57. As for search goods and experience and credence goods, see the pioneering works of Nelson, "Information and consumer behaviour", 78 *Journal of Political Economy* (1970), 311; Darby and Karni, "Free competition and the optimal amount of fraud", 16 *Journal of Law and Economics* (1973), 67; and today Magat, "Information regulation", in Newman (Ed.), *The New Palgrave Dictionary of Economics* (Macmillan, 1998); Furubotn and Richter, *supra* note 28, p. 318–326; Schäfer and Ott, *supra* note 20, p. 465 et seq.

been search goods in traditional marketing processes can lose their quality in a different marketing process, but can regain it via revocation rights.⁵⁸ A comparison of conditions and prices becomes possible again. Information to be given according to the Package Travel and the Timesharing Directives discloses qualities which would be visible later, but are not evident at the moment of formation of the contract. Experience goods are thus transformed into search goods. It is, however, disputed whether too much information is asked for. This not only burdens the seller (excessively) but, even worse, it can induce the demand side not to consider the information given or to consider it only selectively and then potentially not in its most relevant points.⁵⁹

If a legislature wants other goods to gain the qualities of search goods and uses information rules for this purpose there is a need to guarantee correctness, e.g. via liability. Also in contract law, the States have a duty already under the EC Treaty to guarantee *efficient liability rules*. According to the case law of the Court of Justice, violation of duties based on EC law has to be sanctioned in an “effective, proportionate and dissuasive” way.⁶⁰ This may mean, *inter alia*, strict liability and no fixing of lump sum damages below average.⁶¹

Economic theory puts *experience goods* on the same footing as search goods under certain preconditions. These are goods whose quality cannot be assessed at the time of formation of the contract, but only when using them. In certain cases, there is no good case for State regulation because market failure is unlikely with these goods as well: in markets where typically the game is repeated, i.e. the client enters into the same transaction several times, negative experience reduces demand with a particular seller and this is an incentive for him to produce quality. One example is a restaurant which profits from regular custom. In EC law (and any other legal order), this idea produces negative effects first. State intervention can be seen as superfluous. Labelling

58. See the similar idea in a classic example in information economics: rules which prescribe that number or other easily recognizable qualities of goods which have been hidden by their packaging have to be disclosed again on the label: *supra* note 20, Schäfer and Ott, p. 465 et seq.

59. For the timesharing directive: Mäsch, “Die Time-Sharing-Richtlinie im Europäischen Verbraucherschutzrecht – Licht und Schatten im Europäischen Verbraucherschutzrecht”, 6 EuZW (1995), 8, 11 and 14; Martinek, “Unsystematische Überregulierung und kontraintentionale Effekte im Europäischen Verbraucherschutzrecht oder: Weniger wäre mehr” in Grundmann, *supra* note 11, p. 511, 521–530. However, the duty to give “accurate information” could include a duty to use a transparent arrangement and to be as concise as necessary. Such a duty is to be found at least in Art. 5 of the unfair contract terms Directive, and the Commission now seems to consider that such a duty is inherent in any information rule: O.J. 2001, C 255/1, 255/40 et seq.

60. Case 68/88, *Commission v. Greece*, [1989] ECR 2965, 2985; Case C-326/88, *Hansen*, [1990] ECR I-2911, 2935.

61. Case 14/83, *von Colson and Kamann*, [1984] ECR 1891, 1908; Case 79/83, *Harz*, [1984] ECR 1921, 1941 et seq.; and Case C-271/91, *Marshall II*, [1993] ECR I-4367, 4409; Case C-180/95, *Draempaehl*, [1997] ECR I-2195, 2219–2225.

rules therefore mainly concern information which cannot be detected by experience (e.g. ingredients). Door step and distance selling contracts can be similar. They may have considerable importance, but termination is often possible only with considerable losses (private health insurance). Often in these cases, markets are such that the game is not played repeatedly between the same partners. A good example is timesharing. The more transactions are anonymous, the higher is the potential need for regulation because the danger of exit does not hit the seller strongly and opportunism becomes more likely. There are, of course, market alternatives such as building up a reputation, for instance with brands. These instruments, however, have problems as well. One is that smaller enterprises are often unable to build up similar reputations (irrespective of real quality).

6.1.2. *Reducing complexity of information*

Rules that reduce complex information to information which is simple enough to be processed by the average client are also important.⁶² Many rules in European contract law are aimed exactly at this. This regulatory choice should always be carefully considered.

Important *examples* are to be found in the annual percentage rate, or the total costs of consumer credits. Complex phenomena are reduced to a simple figure and comparison is rendered much easier. In this process, however, it is the legislature who fixes which parameters are relevant. He can include too little: the problem of excessive prices has mostly been solved in consumer credits by introducing the annual percentage rate but consumer insolvency remains a problem.⁶³ Even taking only information rules, more could be conceived: there is no provision that information about “total costs” should include model calculations of how costs develop in case of default and the consequences of

62. EC law takes an average consumer as its standard, whereas German law protected consumers where a fairly simplistic consumer could misunderstand the advertisement: see e.g. Sack, “Das Verbraucherleitbild und das Unternehmensleitbild im europäischen und deutschen Wettbewerbsrecht”, (1998) *Wettbewerb in Recht und Praxis*, 264 but see now Köhler and Piper, *Gesetz gegen den unlauteren Wettbewerb*, 2nd ed. (Beck, 2001) 63, paras. 50–56. This difference is even more important in the questions discussed here. In unfair competition, also protecting simplistic consumers only means that advertisements have to be (over)explicit. In the question discussed here, however, also protecting simplistic consumers would lead to the reduction of the range of qualities or conditions for all consumers, so also the 90% less simplistic.

63. Very early already: Holzschek, “Konsumentenkreditaufnahme und Verbraucherverschuldung in der Bundesrepublik Deutschland”, Münstermann, “Zu dem Vorschlag einer EG-Richtlinie über den Verbraucherkredit”, and Steppeler, “Vorvertragliche Information, Vertragsabschluß und Widerrufsrecht im Entwurf einer EG-Verbraucherkredit-Richtlinie und in nationalen Verbraucherkreditgesetzen”, all three in Hörmann (Ed.), *Verbraucherkredit und Verbraucherinsolvenz – Perspektiven für die Rechtspolitik aus Europa und den USA* (Bremen Univ., Dr.-Schr.-Lager, 1986), p. 66 and p. 610 et seq. and p. 592–595.

unemployment – the two typical cases. Whether information would produce effects here or not is, however, questionable given the experience with tobacco advertisements. Requiring information on all relevant facts is a more open rule which, however, is less predictable in its application. Other legal measures are also aimed at reducing complex information. The Payments Directive constitutes one example, and similar solutions are conceivable within the insurance sector.

6.1.3. *Information intermediaries extending party autonomy (investment and insurance)*

The role information intermediaries may play can be deduced *a contrario* from the afore-mentioned points. In the cases of search goods, or of experience goods in a repeated game situation, (and also in cases of goods which become search goods by reducing the complexity of information), it is sufficient to inform the client himself. This is different with experience goods in other situations and with credence goods – goods with qualities that cannot be detected by the client during the use of the item. In these cases, there is similar professionalism needed on the demand side.

If the value of the good is such to pay for it, the use of information intermediaries can be compensated. This allows for maintaining freedom and choice and variety of products. The *alternative* would be to accept that there is market failure and impose a *substantive mandatory solution*. An example for this latter solution is in most countries the law on unfair contract terms. An example of the first solution is the already existing EC law on investment intermediaries and the proposal of an EC directive on insurance intermediaries, which would contain a similar intermediary solution.⁶⁴ As in investment services, a permission prerequisite would be introduced, for reliability and partly also for solvency standards. But, the home country's permission must then be accepted by all Member States (European passport).

The *model* is particularly clear in the regime which already exists. Investment banks act as information intermediaries in investment services. They *process complex information* which issuers give in standardized disclosure instruments (prospectuses, interim statements, on the spot disclosure of new material facts). These instruments are so complex that only equally professional circles can process them (mainly institutional investors, analysts and intermediaries). Intermediaries then have the duty to inform the client according to Article 11(1)(4) indents 4 and 5 ISD on the product (financial instrument) and on the suitability of that product for the particular client –

64. See more in detail for both forms and for the following: Grundmann and Kerber, "Information Intermediaries and Party Autonomy – the example of securities and insurance markets" in Grundmann, Kerber and Weatherill, *supra* note 10, p. 264 (also for references for the legal measures and the very recent initiatives in insurance mediation).

paying particular attention to his degree of professionalism as stated in the Directive. In sum, the core task of information intermediaries is to transform complex and standardized information into information appropriate to the individual client, i.e. reduce complexity and apply the information to the individual case.⁶⁵

The use of information intermediaries has its advantages, but also its problems to which legal regulation has to respond. Information intermediaries should basically guarantee adequate information of the client. The *advantages* can be *enhanced by a legal regime*. Using information intermediaries leads, first, to economies of scale and of scope. Intermediaries create information in the form of general expertise and specifically for certain products, in both respects for a much larger number of cases than clients. Cost of gathering information can be better amortized, therefore allowing for broader and more pertinent knowledge to be acquired. A more rational choice can be taken from a broader range of products. Economies of scale concern both the instrument and the suitability for the particular client. In-depth studies and expertise are necessary also for the second aspect. This advantage of information intermediaries is fostered in EC law mainly by giving intermediaries a European passport. They can thus offer their services and knowledge about products (e.g. an Irish insurance policy) to a broader public. Information intermediaries can also reduce or do away with principal-agent problems (conflicts of interests) between client and seller. If the intermediary does not have financial ties with the issuer or insurer, he will judge products more objectively. This concerns both the issuer or insurer (e.g. his solvency) and the contract conditions.

The use of information intermediaries also has *problems*. Reducing these is (obviously) the core aim of the legal regime. Most importantly, intermediaries can have *conflicts of interests* with clients, which are often less noticable. For example, a very real problem in the investment and insurance industries, is when the intermediary has an interest in large transaction volumes because his remuneration will be calculated on them.⁶⁶

The ISD obliges intermediaries to *avoid conflicts of interests*, if feasible, or at least to disclose them (Art. 11(1)(4) indent 6). This rule is not taken very

65. See e.g. Grundmann and Kerber *supra* note 64, p. 264; Heinze, *Europäisches Kapitalmarktrecht – Recht des Primärmarktes* (Beck, 1999), p. 376–386.

66. Churning and similar ways of promoting transactions for income purposes violate the duty of loyalty, which is to be found in Art. 11(1)(4) indent 1 ISD and in all fiduciary relationships, brokers also. For investment services see e.g. Cahn, “Grenzen des Markt- und Anlegerschutzes durch das WpHG”, 162 *Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht* (1998) 1, 39; Rössner and Arendts, “Die Haftung wegen Kontoplünderung durch Spesenschinderei (Churning)”, (1996) *Wertpapier-Mitteilungen* (WM), 1517, esp. 1525 et seq.; Koller, § 31 WpHG, para. 11, 16 et seq., in Assmann and Schneider (Eds.), *Wertpapierhandelsgesetz – Kommentar*, 2nd ed. (Schmidt, 1999).

seriously. A bank which markets an instrument issued by an affiliate may not underline these financial ties, but use it as a means of publicity (“affiliate of our house”). The bank must, however, also disclose the mechanism of conflicts of interests emanating from these ties. *Three degrees of conflict* can be distinguished (also in recent legislation). The conflict is strong, if the intermediary has financial ties with the seller (issuer) and there is a remuneration interest in the transaction which, moreover, differs from product to product. Products of members of the group are offered more easily. *De facto*, the freedom of the client in Germany to choose is not much bigger than with one firm’s intermediary selling only the products of his firm.⁶⁷ Typically, the client does not even realize this. The conflict is attenuated if the intermediary does not have such ties to one issuer and the commissions are the same for all products. To introduce this as a mandatory rule was unthinkable in a universal bank system. The protection of professional titles or denominations (e.g. “independent broker”) could have similar effects, i.e. an information model which would leave freedom of choice to the intermediaries. A precondition for the functioning of this latter solution would be that the title or denomination is increasingly understood. Contrary to the case with a mandatory rule, the market can still decide whether intermediaries with such financial ties may in fact produce better results for clients for other reasons, for instance because of better economies of scale.

The *third mechanism where the incentive structure is best* could again be prescribed as a mandatory rule or be helped by protection of a denomination. This is neither the case nor the plan in either the investment service or the insurance business. The best incentive structure is to be found with intermediaries who only sell information for which their remuneration, however, does not depend on the transaction volume. This type of intermediary may be in a difficult position anyway because clients may be inclined to pay only if they complete the transaction. Protecting a meaningful denomination could help. In one respect the existing Community regulation is counterproductive and even handicaps the intermediaries with the best incentive structure. Many authors interpret Article 11(1)(4) indents 4 and 5 ISD as a mandatory rule which imposes information duties.⁶⁸ According to this view, clients cannot

67. In investment services, apparently in 50–75% of the cases intermediaries sell own products or products of members of the same group of companies: see *Stiftung Warentest, Finanztest* 12/1997, p. 13 et seq.

68. This is often thought to be the case in Germany: see Köndgen, “Rules of Conduct – further harmonization” in Ferrarini (Ed.), *European Securities Markets – the Investment Services Directive and beyond* (Kluwer, 1998), p. 115, 117 and 128 et seq.; Koller, *supra* note 66, para 91, 126–128; Metz, “Discount-Broker – Bankgeschäfte und technologische Veränderungen”, (1996) *Verbraucher und Recht*, 183, 183 et seq.; and to a certain extent even the German legislature: *Bundestags-Drucksache* 12/7918, p. 104; and also the German Securities and Exchange Commission: Principle No. 3.2 of “*Richtlinie des Bundesaufsichtsamtes für den Wertpapier-*

opt for the execution of the transaction only and renounce the information and advice and pay smaller commissions. As many transactions can be executed only by investment banks, especially in listed stock, clients cannot opt for the execution of the transaction without counselling, for which they have to pay. This drains the pure counseling market, as customers will typically not want to pay twice.

6.2. Freedom of choice

Apart from adequate information, which the party concerned can process, there is a need that the party can still act on it, i.e. that it still has the freedom of choice. Typically, this is *not problematic in European contract law*, but it is potentially so in company law.⁶⁹ A number of cases have to be distinguished. Those rules concerning the acting of the company with respect to third parties are no different from those in European contract law. The same is true for cases in which (potential) shareholders are protected in their investment decisions. For these cases, the 1st and 2nd Company Law Directives and the Accounting Directives (4th, 7th and 8th Company Law Directives) should guarantee reliable and understandable information. They also contain (some) substantive mandatory law, especially within the 2nd Directive. This is different with rules concerning the relationships within the company. Information rules supplemented by a freedom of choice have to be distinguished here from those not supplemented in this way. The first kind is still the normal case, at least as far as the adopted measures go. The law of restructuring – only the 3rd and the 6th Company Law Directives (merger and scission) have been adopted – is based on four elements: information given by the board in a restructuring plan; certification of the information via independent inspection; and then two further options: by the shareholders as a group on the plan as a whole, or (mostly) also by the individual shareholder on his personal investment.⁷⁰

handel zur Konkretisierung der §§ 31 und 32 WpHG für das Kommissions-, Festpreis- und Vermittlungsgeschäft der Kreditinstitute” of 26 May 1997, *BAnz.* (1997), 6586.

69. See in more detail for the following Grundmann, *supra* note 10.

70. Hommelhoff and Riesenhuber, “Strukturmaßnahmen, insbesondere Verschmelzung und Spaltung im Europäischen und deutschen Gesellschaftsrecht” in Grundmann, *supra* note 11, p. 259, 272–279 (also for exceptions and for a similar model in other cases of restructuring); similar view: Lutter, *op. cit. supra* note 53, 1, 4 (these are “instruments ... modern and efficient”).

7. Outlook: Information problems as the core question in systems competition

It is not just the EC Treaty itself which gives supremacy to information rules over substantive mandatory law when possible: in secondary law too, especially in European contract law, information rules dominate. Various mechanisms are employed in order to enable the party which is less informed to take rational wealth-maximizing decisions. The techniques vary according to whether search goods, experience goods or credence goods are involved.

The *advantage of an information model* which justifies its supremacy in EC law is that market mechanisms are to a large extent maintained, and with this also the freedom of the person and parties' autonomy. Public decision does not discard individual preferences. Wherever this is possible, the principle of proportionality speaks in favour of this solution. A second advantage, now of integration policy, is that consensus can be reached more easily for information rules. Disputes about content and about mandatory substantive solutions can be avoided. The legislative history of the Unfair Contract Terms Directive is illustrative in this respect. There was consensus that information asymmetries were such that the range of possible choices had to be considerably reduced in order to protect the client. However, it was not possible to harmonize the points of reference from which the professional should not be allowed to diverge substantially. On these points, national law was upheld. This approach was criticized because the same clause could be judged unfair under one national law in combination with the Directive and be the solution proposed by the legislature in another country and then even be exempt from any control under Article 4 of the Directive.⁷¹ The concentration on information rules and the fact that the Community legislature is particularly innovative in this area is understandable.

Information is, however, important also where *no harmonization* has taken place. This concerns national rules going beyond the minimum standard introduced by the EU and national rules falling outside the ambit of application of a Community measure. In these areas, *systems competition* is growing stronger. This is particularly true for European contract law. For most areas there is freedom to choose the law applicable to contracts. The other areas have mostly been subject to harmonization, giving each seller the right to design his or her products and conditions according to his or her law and sell them all

71. Remien, "AGB-Gesetz und Richtlinie über mißbräuchliche Verbrauchervertragsklauseln in ihrem europäischen Umfeld", (1994) *Zeitschrift für Europäisches Privatrecht* (ZEuP), 34, 59; tending the same way, Joerges, "Europäisierung des Privatrechts als Rationalisierungsprozeß und als Streit der Disziplinen – eine Analyse der Richtlinie über mißbräuchliche Klauseln in Verbraucherverträgen", (1995) ZEuP, 181, 185; for an opposite view see Grundmann, *supra* note 2, 2.10 paras. 12–14.

over the Community, providing his or her law reaches the minimum standard of the Directive. If, therefore, the systems increasingly compete, because borders become more permeable, information becomes the core problem for the efficiency of such competition. If the demand side is to profit from such competition it has to be in a position to receive and process material information and to take rational wealth-maximizing decisions on this basis. A condition of systems competition is not only the opening of borders but also, as shown in information economics since the 1970s, the existence of intelligent information rules which render the competing conditions transparent. The lessons derived from standard term contracts, annual percentage rates and labelling rules, have to be applied at a new level if the constitutional framework for an interplay of integrated national legal orders is to work efficiently.⁷² (Contract) freedom and information – these are core questions for an Internal Market Law.

72. On these questions, which become still more important after the Commission's Communication on European Contract Law, *supra* note 59, see Grundmann and Stuyck (Eds.), *An Academic Green paper on European Contract Law* (Kluwer, 2002), esp. the papers by Kirchner and by Grundmann and Kerber.

